PART 4

Case Study Findings

4.1 Preamble

Our examination of the seven case study properties in this consultancy has resulted in the emergence of a series of findings and thematic outcomes. These findings and themes relate to issues which are central to the stated objective of our undertaking, which is to examine the economic impact of heritage listings upon commercial investment property classes, both from the property development and passive investment perspectives. The series of themes and outcomes are discussed under separate sequential headings, as follows.

4.2 Difficulties of Adequate Data Collection

To address the objectives of this consultancy in a 'perfect world' scenario, it would be ideal to have been able to obtain the full particulars of the complete financial feasibility studies carried out by the subject developers in each of the four cases where major redevelopment projects were conducted.

The reality is, unfortunately, that such essential 'hard core' financial information is rarely able to be secured from the participants. As is the case in many other business environments, it is the long established custom and practice within the property industry, rightfully and understandably, that such detailed information is held to be of a strictly private and confidential nature, and therefore not suitable for disclosure. Such information is usually only disclosed to consultants acting for the party concerned, where a formal client-consultant business relationship exists (for example, where a property economist is acting for a developer). Even then, considerable efforts are expended to safeguard client confidentiality.

Accordingly, in our discussions with the developers, or their nominated representatives, we have had to rely on their willingness to provide certain limited financial details, suitable from their standpoint for release into the public domain. Therefore, we have had to form conclusions based upon the limited threads of financial feasibility data available.

In several of the cases, the information gathered in relation to Project Costing was very detailed. As a general rule it proved far more difficult, however, to secure detailed information relating to Value-on-Completion data. Without this, it is not possible to extract profitability conclusions of any precision.

Similarly, in the three cases which constituted passive commercial investment assets, a similar obstacle was encountered. Much of the information furnished was of a descriptive nature only, as opposed to detailed financial figure-work.

Moreover, the private-sector case-study participants with whom we dealt were able to provide only very limited time, out of their very busy business schedules and priorities, for the purposes of providing availability for interview.

Our consultancy task also required that the relevant records of local government be accessed. We wish to publicly acknowledge the immense co-operative efforts of local government officers in making themselves available for consultation and in providing access to relevant property records. However, in some instances the data able to be secured was only partially available and partially complete. In one case, the records were unable to be located for us at all.

It is anticipated that this fundamental problem of core-data unavailability and inadequacy will continue to be a major obstacle, should any future heritage case study projects of a similar nature to our consultancy be contemplated.

4.3 Developers' Objectives and Priorities

It is noted that in each of the four redevelopment case studies, the underlying investment objective of the developer was to retain and on-manage the project, as opposed to the pursuit of an immediate develop-and-sell strategy.

In the three Sydney CBD cases (Sydney GPO, Medina Apartments, Radisson Plaza Hotel), the projects as at start of 2001 are now being on-managed in orthodox investment scenarios, without any element of direct owner-occupational usage of the building (apart from the presence, perhaps, of on-site management staff). Only in the single regional-country based case (Maitland) has the developer adopted a partial owner-occupation usage, which is to use one of three floors as their place of residence.

The anecdotal evidence collected from the developers (or their representatives) reveals that, in the main, the presence of the heritage-listed status on the subject property was not the prime factor driving their decision-making in the development process. Rather, the majority of respondents (Sydney GPO, Medina Apartments, Radisson Plaza Hotel) declared that the following factors primarily determined their decision to commit to development :

- the presence of a perceived prime commercial *location* (i.e. a site-related consideration more than a building-related one).

- the initial potential for the opportunity to secure a favourable position in the particular sub-market category (eg hotel, serviced apartments) - as a result of market research which disclosed factors such as buoyant demand, a shortfall in available supply to meet the demand, and a favourable sub-market property cycle conducive to development.

- the future potential for sound investment performance of the projected development proposal, given its particular intended commercial use category (hotel, serviced apartments) and its positioning in the relevant sub-market.

This scenario is consistent with the same normal, historical decision-making process exhibited by developers of non-heritage property assets, and the criteria outlined above are in line with orthodox commercial investment and property development principles.

While the presence of a heritage-listed property status was not the key attraction for these developers, it can also be said that nor was the heritage-listing an anathema or insurmountable obstacle to them, from a pre-emptive attitudinal standpoint. In other words, none of the three CBD developers were disinclined to deal with the property simply because it happened to be heritage listed.

In two of the cases (Medina Apartments and Radisson Plaza Hotel), the developers outrightly stated that the heritage characteristics of the property were strictly secondary considerations to them. In the case of the Sydney GPO, it appears that the heritage aspects of the scheme were of considerably greater importance to the developer, particularly from the perspective of the integrated mixed-use nature of the completed development product. The GPO building enjoys an intimately connected relationship with the non-heritage development erected behind it, and so is a crucial component of the entire scheme.

Given the prominence and magnitude of the GPO scheme, it is clear that a certain degree of prestige and enhancement of business reputation for the developer was also a factor of some regard.

The crucial exception to the above was in the Maitland case (regional-country locale). There, the evidence suggests that, from the outset, the developer possessed a strong, positive attitudinal predisposition towards the development of a heritage-listed property, and in particular, the subject property. In other words, it appears that the subject property at Maitland was deliberately targeted by the developer due to its inherent heritage characteristics, and the fact that it was afforded protection via its statutory heritage listing. Here then, the heritage aspect constituted the primary driver in the development decision-making process.

This marked contrast between the city and country scenarios may suggest a potential paradigm attitudinal differentiation, the nature of which might be suitable for more detailed future research.

4.4 Development Economics - Cost Versus Value

We have approached this theme from two standpoints : firstly, the concept of <u>initial</u> development profit versus the separate concept of <u>future</u> performance of the investment asset, and secondly the issue of added costs incurred as a result of meeting mandatory heritage requirements within the development scheme.

(i) Indications As To Initial Development Profit, and Comparison With Expected Future Investment Returns

In the simplest of terms, it is possible to assess project viability through an examination of Development End-Value versus Total Project Costs. Using this elementary Profit Residual approach, the measure by which End-Value exceeds Project Costs provides a prima facie indication of Initial Development Profit. As already emphasized under heading 4.2, the necessary detailed End-Value financial information required to reach concrete conclusions under this category is unfortunately, in most cases, unavailable to us in sufficient volume and detail.

However, based upon the limited information available, it would appear that the level of Initial Development Profit varied considerably from project to project. In three of the four redevelopment cases, it seems that a clear profit was recorded. The exact degree of proportional profit in percentage terms is however difficult to quantify precisely in each case. The degree of proportional profit would appear to have been low to marginal in two cases, and somewhat more attractive in a third case. In a fourth case, the indications are that the initial profit was, at best, marginal, and at worst, that Cost and End-Value were about neutral.

However, it would be invalid to read too much negativity into these results. Because all four projects were undertaken on an 'on-hold, on-management' basis, it is the future investment performance of these assets, and the returns generated therefrom, which take on the most importance, as opposed to a mere initial profit at commencement of the holding period. This is particularly the case with development projects of larger magnitude, where the initial development profit may appear small in proportional terms yet may nevertheless remain considerable in sheer dollar-sum terms.

In this regard, all four developers (or their representatives) spoke in very confident terms of the favourable manner in which they view the prospects for handsome capital value and net cashflow growth, over the medium term for the properties concerned. At least two of the four owners (Radisson Plaza Hotel and Maitland) expressed definitive intentions to hold their assets for long term periods. Such positive future expectations are well in line with the investment objectives and market research criteria which drove the original development decision-making process, which we have already discussed under heading 4.3 above.

(ii) The Added Development Costs of Meeting Heritage Requirements

Sufficient Project Costing data was available through our field investigations to reveal what we believe to be reasonably accurate findings as to added costs of heritage listings and their associated requirements in a property development context.

It stands to reason, in our opinion, to expect a scenario whereby the Design and Construction Costs in a heritage-listed development project will, in the most generalized sense, be found to increase proportionately, as a direct result of various restoration, reinstatement and reconstruction requirements that attach to the given heritage building.

The potential for variation in the proportional degree of extra cost of heritage-related works is, however, considerable. The degree of excess cost will depend on a mix of multiple variable factors, such as the existing state of repair, structural integrity and age of the building; the exact particulars of heritage significance in individual cases; whether the required heritage works are of an internal or an external nature (or both); and finally (but by no means least) the <u>magnitude</u> of the building involved (expressed through the number of floor levels and the size of floor plates).

Across the spectrum of our four redevelopment case studies, we have found the degree of added Project Cost, directly attributable to meeting the requirements of a subject heritage listing in a particular building, has ranged between 4% to 15%.

The available evidence suggests that, in line with the concept of 'economies of scale', a *lower* <u>relative</u> added heritage cost level is more likely to be found in *larger-scale* projects.

We suggest that it would be invalid and excessively simplistic to read too much negativity into this finding. While on the surface such a finding might be grasped with glee by those who oppose heritage conservation as a concept, this finding has to be analysed more deeply. Added heritage-related Project Costs examined in isolation are of little meaning. To reveal the real economic impact and true overall implications of a heritage listing, they need to be weighed up, counterbalanced and placed alongside the financial benefits and positive offsets which frequently accrue under the incentive provisions inherently contained within the statutory heritage protection system.
In this regard, the true economic impact of the heritage listings in all three of the Sydney CBD redevelopment case studies has been revealed as most positive. In particular, the cost-free FSR bonuses which were conferred upon these three properties have resulted in very handsome value-added superiority ratios where the proportion of Added Value has exceeded the proportion of Added Cost, several times over.

This leads on directly to the next theme in our series of Case Study Findings.

4.5 The Economic Impact of Heritage Incentives on Heritage - Listed Development Projects

(i) Floor Space Bonus Awards

Our investigation of the property records held by the Council of the City of Sydney reveal that in <u>each</u> of the three Sydney CBD redevelopment cases, substantial cost-free Floor Space Ratio (FSR) Bonuses were awarded to the projects.

These Floor Space Bonuses equate to the addition of approximately 14% over the existing floor space in the Radisson Plaza Hotel case (11.91:1 as opposed to 10.44:1), an addition of approximately 27.5% over the standard FSR code for the Sydney GPO scheme (12.75:1 as opposed to 10:1), and an addition of approximately 25% of gross rooftop floor space (compared to the existing gross building area) for the Medina Apartments project. In the Medina case, the net effect of the rooftop addition represents an increase of approximately 20% in the number of apartments permitted in the development scheme.

The issue of FSR bonuses was never a matter for consideration in the Maitland case, and so it is excluded from discussions under this category.

The GPO and Radisson Cases.

In the Sydney GPO and Radisson Hotel Plaza cases, the FSR bonus was directly attributable to the *'Incentive Floor Space Ratio For Hotels'* provisions of Council's Hotel Policy under the Central Sydney LEP 1996. It is also notable that in its determination of the FSR awards, Council had additional regard to '*the public benefit gained in having accommodation of this nature available in time for the Sydney Olympic Games*' (cited from Council consent records).

Council's consent records also show that a related Heritage Floor Space (HFS) default penalty provision operated, whereby a time deadline for project completion of 30 June 2000 - just prior to the onset of the Sydney Olympic Games - was established under the above policies. If the projects were not completed at or before 30 June 2000, then the developers would have been required to **purchase** the floorspace bonus (above and beyond the 10:1 standard FSR level) as if it was HFS, calculated at the then HFS current market price.

Thus, it can be seen that under this pre-Olympic Games incentive, the Hotel FSR bonus was awarded on a cost-free basis to the developers, on the proviso that project completion would occur by a nominated time deadline. While in a default scenario the FSR bonus would still have been available (being converted instead into a HFS *purchase*), the cost-free nature of the bonus represented a significant financial incentive in and of itself.

Clearly, the FSR bonuses which were awarded in these instances do not constitute a direct award of Heritage Floor Space. Rather, they represent 'special' pre-2000 Olympics related financial incentives which in effect superceded and over-rode the pre-existing heritage-related HFS financial incentive provisions which were already available under the statutory heritage and environmental planning system.

While they have, in practical terms, *replaced* the HFS financial incentive provision in these two cases, there is nothing to suggest that the same potential effective Floor Space Bonuses would not have continued to operate in the same way through the eligibility of an award for HFS, were the Sydney Olympics factor to have been hypothetically entirely absent from considerations.

The Medina Apartments Case.

In the case of the Medina Apartments project at Railway Square, the FSR bonus was determined in a somewhat different manner. Essentially, it was ultimately awarded on a cost-free unfettered basis as part of a broader pre-Olympics Masterplan upgrading proposal for the Railway Square Precinct, and in place of an original HFS application by the developer. The outcome also constituted the result of a negotiation and bargaining process between the subject developer and the relevant planning authorities.

The provision for the addition of two rooftop floors to the existing six-storey former Parcels Post Office building had been envisaged, in conceptual terms, during the mid 1990's as a result of early financial feasibility studies for the site, conducted on behalf of the owner and public authorities concerned, at the time when the Central Railway Precinct West Side Masterplan was being formulated These financial feasibility studies had indicated the desirability of additional rooftop floor space in order to enhance the economic viability of the hospitality-based adaptive re-use which was envisaged for the property.

Likewise, the rooftop addition was approved in principle in the development consent of July 1998. The FSR bonus in this case was not awarded under the pre-Olympics 30th June time deadline provisions of the Hotels Policy. Rather, it was ultimately viewed by the various statutory authorities as an essential pre-requisite for financial feasibility of a desired hospitality-based redevelopment scheme for the subject building, *in isolation*.

In effect, an original application by the developer for an award of HFS was withdrawn by the developer, in exchange for development consent being granted for a rooftop addition, the *design* of which particularly suited the developer's needs. The developer, Toga Pty Ltd, held substantial bargaining power in the approval process, since its development tender was the sole proposal submitted which came close to meeting the adaptive re-use guidelines of the Masterplan. The end design of the two-storey rooftop addition is, however, a somewhat controversial one, having drawn considerable commentary from various sources as to its degree of sympathy with the form and fabric of the main heritage building below it.

This outcome demonstrates that it is indeed sometimes possible for the developer to secure the upper hand in negotiations on heritage-listed redevelopment schemes.

In all three of the Sydney CBD redevelopment cases, it can be concluded that the FSR bonus awards were of such magnitude that they may well have made the crucial difference between the projects being feasible and unfeasible in an economic and financial sense. Given the somewhat slim initial development profit margins which *appear* to have existed in several of the cases (refer back to heading 4.4 (i) in this section), it is not unreasonable to envisage a scenario where the economic viability of all three Sydney CBD redevelopment cases would have been severely detrimentally affected (and possibly even have been rendered null and void) had the cost-free FSR bonuses not been provided by the relevant authorities.

(ii) Adaptive Re-Use Considerations

Our case-study coverage under Part 3 of this Report provides detailed descriptions of the individual Adaptive Re-Use provisions in each of the four redevelopment scenarios.

It can be concluded in all four of the case studies that the adaptive re-use schemes have constituted effective inducements in encouraging redevelopment to take place. The adaptive re-uses in each case are, in our view, creative, flexible and dynamic in a contemporary commercial investment sense. Yet, at the same time, they are sympathetic with the heritage features of the given property, and they have maintained an integrity with the key objective of preserving the best features of heritage significance in the buildings concerned.

An adaptive re-use application to a particular heritage-listed property must, by nature, be determined on an individual, 'on-merit' basis. Adaptive re-use potential is directly governed by the individual heritage significance characteristics of the building concerned.

Furthermore, in assessing the financial inducement 'package' which applies to any given heritage-listed redevelopment scheme, the different contributory elements - bonus FSR or HFS awards, the essential commercial nature of the adaptive re-use proposal, and the fundamental heritage significance characteristics - must be treated as component parts of the whole incentive package, and not as isolated, unconnected entities. The design and construction parameters in a redevelopment scheme will be governed by a combination of all of these factors, operating together.

In the Radisson Plaza Hotel and Medina Apartments cases, the primary heritage significance, and consequent retention and restoration works, are to be found in the external form and fabric of the buildings. In practical terms this has permitted the internal parts of the buildings to be stripped back, virtually completely, to the building shell, for the purposes of redevelopment and dedicated commercial alternate re-use. This can be seen as being to the developer's great advantage in each of these cases, because it has permitted the fitting out of virtually the whole of the building interiors (internal design, décor, finishes, building services) on an 'as-new' basis, which considerably enhances the future economic performance potential of the newly-adapted commercial property use.

By comparison, in the Sydney GPO case, considerably more interior significant parts of the heritage building have been retained or reinstated (e.g. vaulted attics in each wing, vaulted basements, the grand staircase), at great expense to the developer. Yet, a range of commercial and other supporting re-uses has been adapted to the building in such a successful way that the functionality of all interior parts of the building has not been compromised, in contemporary commercial usage terms. In other words, there are no valueless, uneconomic or dysfunctional 'voids' which exist.

Moreover, prior Heritage Conservation and Adaptive Re-Use Guidelines had already been put in place by the former public-authority owners of the GPO and Parcels Post Office properties, well before the current developers came onto the scene. These pre-emptive Guidelines can be seen to have represented a considerable time and cost saving for the developers concerned, since they enabled the preparation of far less complex development tender submissions. In effect, much of the Heritage Conservation Management Plan work had already been done for the incoming developers.

Even in the case of the Radisson Plaza Hotel, pre-emptive guidance was provided for the incoming developer due to considerable prior conservation and adaptive re-use planning work conducted by former owner Westpac, and its design consultants.

Finally, the Maitland case really has to be considered as a separate entity, due to its regional-country location in a local, small, struggling commercial market. The redevelopment outcome, however, is seen by us to be most successful from an Adaptive Re-Use perspective. The fine old heritage building, and its immediate environs, were in a significantly depressed, run-down condition prior to redevelopment. The implementation of the Heritage

Conservation Management Plan by the new owner has seen the property come to life again in a spectacular manner. The redevelopment project has been very well accepted and embraced by the local Maitland community, and the twin objectives of commercial viability and sympathetic heritage conservation appear to be soundly in place.

4.6 Subsidiary Property Development Issues

(i) Relations Between Developers and Statutory Authorities

In the course of our field-based investigations, each of the four developers (and / or their representatives) was interviewed, and asked to comment upon their relations with the various statutory authorities, and their experiences with the development approval process and heritage conservation process.

Almost without exception, the respondents spoke very favourably in respect to their dealings and interactions with the Heritage Council and Heritage Office. The developers in the main remarked that the heritage authorities displayed a commercial astuteness, and an empathy and understanding of the commercial needs and objectives of the developers concerned.

Mr Robert Young, Chief Property Manager, No.1 Martin Place (personal communications, 9/10/00 and 18/12/00) in particular commented upon the very strong, positive relationship which was maintained between the project architects, the design team, the heritage architects, the Heritage Council and the Heritage Office throughout the course of the Sydney GPO redevelopment scheme. In the opinion of Mr Young, this environment of mutual understanding and appreciation contributed markedly to the successful completion of the project in a tight, efficient manner.

It was found, not unexpectedly, that those incoming developers who lacked a substantial background and track-record of previous heritage-system and heritage redevelopment experience in local or other Australian environments, were the ones who encountered the most difficulty with the heritage aspects of the development approval process.

(ii) Developers' Concerns - Time Delays

All four developers commented to varying degrees that, in their opinion, inefficiencies were experienced with undue time delays during the development approval process.

This problem is by no means a new one, and has been well documented in various industry and media literature for many years. A series of media articles published throughout the 1990's have commented upon the presence of time delays in the statutory approval process associated with non-heritage development environments. The issue in a property development sense is a generic one.

It may well be the case, in NSW at least, that the 40-day approval time limit embodied in the Environmental Planning & Assessment Act 1979 may perhaps have been over-optimistic (perhaps even unrealistic) from the outset. A revision and extension in statutory timeline terms might possibly be appropriate, to help alleviate the pressures so created.

In heritage-listed redevelopment schemes, the additional mandatory involvement by heritage authorities, additional to that of the wide range of pre-existing statutory participants, adds but one more dimension to a planning approval process which is already operating under much pressure, with a high demand for services and limited resource constraints.

The concept of a 'one-stop shop', and of greater use of single-venue round-table meetings to address the various statutory interests and issues which arise in the approval process, has already been identified by government as potential solutions to help alleviate concerns of this nature.

4.7 The Property Asset Management Perspective - All Cases

Under this asset management category, there was little cause for concern expressed by the owners in the four redevelopment cases. This is primarily because each of the cases constitute virtually 'as new' premises after their extensive redevelopment. Internally, all four projects have been refitted with contemporary building services and facilities, thus offering the high levels of operating cost efficiency commensurate with that of a 'brand new' commercial premises.

In the three 'passive investment' cases, the asset management perspective is of significantly more importance. Therefore, Case Studies No. 2. (Parramatta), No. 3 (The Strand Arcade), and No. 7 (Moran House) feature prominently in our discussions under this theme, since they each constitute 'existing-use' passive commercial investments as opposed to recent major adaptive re-use schemes.

Our following analysis focuses upon the impact of heritage listings on the achieveable market rentals, annual operating costs and life-cycle costs, as they pertain to the three case studies in our series which constituted passive investment assets. Where it is appropriate to make brief, one-out mention of any of the four redevelopment cases in this context, we have done so.

(i) Income Levels

The level of achieveable rentals and income in our passive investment cases appear to be neither detrimentally nor beneficially affected by the presence of a heritage listing. In other words, the impact under this category seems to be neutral.

There appears to be no evidence which we can discern of the presence of *premium rental* levels, which might be attributable directly to the presence of a subject heritage listing. We had expected that there might possibly be evidence of premium retail rentals in the Strand Arcade case, however Mr Alan Champion, Operations Manager, Ipoh Ltd, (personal communications, 21/12/00) confirmed the absence of any such premium there. Interestingly, however, Mr Champion stated that premiums are being achieved in the retail rental levels in the heritage-listed Queen Victoria Building (situated in close proximity to the Strand Arcade, and also owned by Ipoh Ltd).

In the main, the same 'rent-neutral' situation seems to prevail within our four redevelopment cases. The sole exception to this finding is in respect to the Sydney GPO case (No. 1 Martin Place), where the heritage hotel room tariff rate (within the GPO building) is charged at $475 per room per night, compared to $432 per room per night for an equivalent serviced room in the non-heritage Westin Hotel tower immediately behind. This represents a gross income premium differential of some 10%, directly attributable to the heritage features present. A corresponding examination of relative occupancy rates between the heritage and non-heritage hotel rooms, which would provide a more meaningful and effective basis for comparison, has not been possible however due to insufficient data being available.

(ii) Annual Operating Costs

Our focus here is once again upon Case No's 2, 3 and 7 - the passive investment examples.

Based upon our interviews with the respective owners, there appears to be little if any detrimental impact on the annual operating costs arising out of the heritage listing associated with both the Parramatta and the Strand Arcade cases.

Both heritage buildings were recently extensively refurbished, thus maximizing the efficiencies achieveable in annual operating costs, relative to their underlying size and physical age. In the Strand Arcade case, the pre-existing site plottage is quite small, narrow and inefficient in a relative CBD commercial context. As a small, underdeveloped low-rise multi-storey retail premises, limited by design and site considerations, the building suffers from inbuilt outgoings inefficiencies, regardless of its heritage listing. Thus, periodic life-cycle capital expenditure programs are required to maintain its optimum financial performance, within the limitations of the total building and design envelope.

In the case of Moran House, a number of difficulties were identified, however. Much like the Strand Arcade, this building suffers in a commercial performance context by virtue of its poor, small site plottage, its correspondingly small sized floor plates, and its fundamental underdeveloped low-rise design. The existing use of the building as commercial offices is also of prime importance in this case, from the standpoint of the economic impact of the heritage listing.

In the case of Moran House, a series of heritage conservation requirements (glass curtain walls, ground floor reception area and mural, spiral staircase to mezzanine, upper floor boardroom) seems to have flowed through into higher annual operating costs (air conditioning, security, limited owner-occupied use potential). A significant counter-argument here is that the current owner purchased the property (for owner-occupation) at a price which reflected all of these alleged detrimental impacts.

Furthermore, it has been established through our investigations of the subject property records at Sydney City Council that Moran House is eligible for the award of HFS, the sale of which by the owner in the market place might be expected to provide a sizeable 'sinking fund' to counterbalance added operating costs in the building.

In closing, the issue of Heritage Valuations for Land Tax discount purposes requires brief discussion. The financial incentive opportunities and statutory eligibility requirements for Land Tax Heritage Valuations over heritage listed properties are well documented elsewhere. However, the degree of discount in the valuation is entirely contingent upon the existing FSR characteristics of the property, relative to the planning code, and the manner in which the characteristics are interpreted by the NSW Valuer General.

In our case study series, the Sydney GPO site enjoys a handsome discount for annual Land Tax purposes of almost 50%. It is our understanding that the Strand Arcade site enjoys the benefit of a Land Tax Heritage Value, although we are unaware of the discount in that case. We are unaware of the Land Tax particulars of the remaining CBD cases. Land Tax discounts have the potential for a significant reduction in annual operating costs of heritage-listed commercial properties, however the degree of discount, if any, will always be contingent on the individual characteristics and case-merits of a given property.

(iii) Life Cycle Costing Issues

In terms of building services and plant and equipment, all of the four redevelopment case studies have been refitted and renewed to virtually an 'as new' standard - in some instances, at great expense. Similarly, the Parramatta case study underwent a recent mid-life renewal and major refurbishment in 1998. None of the owners in these five case studies have commented adversely in respect to life-cycle costing issues.

However, in respect to the two remaining case studies - the Strand Arcade and Moran House - we would, in closing Part 4 of this Report, make the following observations.

The Strand Arcade.

Ipoh Ltd have owned this retail investment asset since April 1999. The asset is regarded as a prime component of the company's property investment portfolio. Since Ipoh Ltd is a publicly listed company, the investment performance of each of its portfolio properties is of considerable importance to a great many people.

Ipoh have plans for a substantial refurbishment program for the Strand Arcade during 2001, to the extent of a $600,000 to $700,000 capital expenditure. The objective is to improve the financial performance of the two upper retail floors in the building. Based on two physical inspections which we conducted in late 2000, the upper floors are in need of a refit, and show evidence of a relatively poor pedestrian-shopper throughput, compared to the vigourous trading levels which are apparent on the ground and basement levels.

As part of the upper floor revitalisation program, Ipoh expressed a desire to install escalator access to the upper retail floors, from the common-area ground floor promenade. While we have not sighted documentary evidence to this effect, we are advised by Mr Champion (op cit) that the installation of escalators has been refused by the relevant authorities, primarily on heritage listing grounds.

In addition, the opportunity for inter-tenancy penetrations (the ability to alter the size and shape of tenancies by altering party walls, floors, ceilings and so on) either vertically or horizontally, which are viewed by owner and tenants as commercially and economically desirable, would seem to be somewhat constrained (but not necessarily unachieveable) by virtue of the Strand Arcade's heritage listing.

In a positive sense, the opportunity for tenancy precincting - that is, the ability to rearrange the tenancy mix throughout the building in order to enhance the owner's economic performance goals - does not appear to have been affected in any detrimental manner by virtue of the heritage listing which is present.

The issue concerning the installation of escalators comprises the most notable area of difficulty in this case study. This example of opposing viewpoints between the owner and heritage managers, which currently seems to be at an impasse, is in our opinion one which gets to the heart of demonstrating the kinds of dichotomies between economic goals and heritage goals which can sometimes arise in heritage-listed commercial properties.

Substantive legitimate arguments for the stance of each vested interest - owner and heritage managers - exist. Nevertheless, some solution must inevitably be found, to the satisfaction of both interests. It is not our intention to suggest a remedy, merely to demonstrate these issues as ones for consideration and contemplation, under the banner of the stated objectives of our consultancy.

Moran House.

The current owner purchased the property in December 1996. In May 1997 the owners lodged a combined Development Application and Application for an award of 2008 square metres of HFS.

The Development Application was partly refused, on heritage-listing grounds, in respect to a 366 square metre floorspace (a lineal 5 metre extension to the streetfront facade) addition and structural infill on the recessed uppermost 5th floor level. Furthermore, the application for the HFS award was refused on the grounds of ineligibility, due to a bureaucratic and regulatory anomaly in the planning scheme which rendered all buildings built after 1957 as ineligible for HFS (the subject building was built in 1961, but met all other HFS award criteria).

While the anomaly has been rectified and the HFS award has subsequently been approved 'in principle' by Council, it has not yet been awarded in practice, since certain bureaucratic procedures now need to be followed for this to occur. The proposal for the upper floor additions remains as a refusal.

The air conditioning plant within the building is obsolete and performing poorly, according to the anecdotal evidence supplied to us by the owner's representative (Mr J. Gillet, personal communications, 20/9/00). The owner regards it as uneconomic on cost-benefit analysis to replace the air conditioning plant, largely due to the use restrictions imposed by the subject heritage listing.

This issue of the air conditioning system is of some concern to the owner from a life cycle costing standpoint. While the property is currently performing perhaps 'satisfactorily' for the purposes of owner-occupation, concerns exist on the part of the owner for the prevention of the erosion of building investment value over the longer term. The future market value, commercial market appeal, and leaseability prospects from an incoming purchaser / investor standpoint are the key issues here, should the owner wish to dispose of the property at some future date.

However, provided that the bureaucratic requirements for the HFS award are met, then the potential value of the sales rights of the 2008 square metres of HFS at market rates would represent a sizeable positive financial countermeasure against the owner's concerns noted above.

PART 5

Conclusions and Recommendations For Future Research

5.1 The Commercial Redevelopment of Heritage Assets

(i) In our opinion all four of our redevelopment Case Studies constitute successful projects. The integrity of the heritage significance features has been successfully retained in each of the subject buildings, while at the same time commercially viable investment assets have been created for the owners through the application of sympathetic adaptive re-use schemes.

(ii) Each redevelopment Case Study, either partially or wholly, involved major hospitality-based commercial adaptive re-uses - five star hotels, serviced apartments, function / conference centre, and bed & breakfast accommodation.

In the largest project, the Sydney GPO adaptive re-use scheme, considerable office and retail uses are also prevalent in what can be described as one of the most innovative and dynamic integrated mixed-use commercial heritage redevelopment projects yet seen in the history of NSW statutory heritage protection and preservation. All project stakeholders and contributors can take considerable pride in this outstanding achievement.

(iii) Prudent developers, both in theory and practice, contemplate commitment to a development proposal in a chosen market and location only in circumstances where detailed market research reveals that the market conditions, and the timing in the relevant sub-market property cycle, are favourable and conducive to project commencement.

The two key objectives of the prudent developer comprise the satisfaction of unmet market demand, and the ability to derive a satisfactory return, relative to the risk exposure, from the outlay of investment capital - either via an initial return in a develop / sell scenario, or via a longer term orthodox investment return in a hold / on-manage scenario.

These fundamental principles of property development hold true, regardless of whether or not a heritage-listed building is the subject of the proposal.

(iv) In our four redevelopment case studies, the developers' decision-making was driven by these principles, first and foremost. The heritage-listed nature of the four subject proposals then became the next crucial factor for consideration in the property development process, in the context of searching out the availability of properties suitable for development (so-called 'site' identification and acquisition in non-heritage scenarios), plus essential research associated with the statutory development approval process. Heritage issues did not pre-empt the initial market research phase of the development process. These findings are in accordance with Whiteside's depiction of the logical, sequential stages of the development process which is included at the end of Part 2 of this Report (refer to page 53, Part 2 herein).

(v) Market conditions relevant to the subject adaptive re-uses, in the specific commercial locations chosen, were found to be most favourable and conducive to development proceeding. The onset of the Sydney Olympic Games can be seen as the most significant market contributor in our three Sydney CBD case studies. The Sydney Olympics influenced not only the local commercial hospitality markets and their participants, but also government policy in the desire to provide sufficient visitor accommodation.

Government policies flowed through into the environmental planning and heritage preservation systems via the provision of cost-free FSR bonuses for our three Sydney redevelopment CBD case studies. However, even in the hypothetical absence of Olympics-related cost-free FSR bonuses, there seems little doubt that the opportunity to secure the equivalent additional floor space for heritage-related development purposes would still have been available via the cost-free award, or if necessary, the purchase, of Heritage Floor Space.

(vi) In our view, the market influence of the Sydney Olympics should not be dismissed as a one-out ‘spike’, but rather as a fortuitous, legitimate market catalyst, which will have beneficial ramifications for ongoing tourist and business-visitor market growth in the relevant hospitality markets (including, perhaps, other significant heritage assets) well into the forthcoming decade. The Olympic factor is really no different in concept to any other public-infrastructure market catalyst (such as the implementation of new freeways, rail links, airports, sea-port facilities, or the creation of new regional growth centres) except that its impact was on a massively bigger scale.

The owners of the three Sydney CBD case study properties recognised the relevant future market potential when they decided to commit to such major redevelopment schemes in an on-management mode, and where the initial capital outlays and ongoing economic stakes were and will continue to be very high. One does not risk such large capital amounts casually.

(vii) In our view, project viability in the three Sydney CBD Case Studies was underpinned by the opportunity to build to extra FSR levels, coupled with the ability to reconstruct the <u>interiors</u> of the subject heritage buildings to an ‘as-new’ configuration. The commercially-oriented nature of the subject adaptive re-use schemes also contributed significantly to the 'package' of factors which led to a positive economic outcome in each case.

In the Sydney GPO example, the availability for redevelopment of the extra rear land within the overall property boundaries was also the crucial factor upon which financial viability depended, in the circumstances of that particular case. The additional rear land permitted the erection of a large prime non-heritage office tower and adjoining major hotel tower, which together with the FSR bonus, drove the financial feasibility process in that case. The generous FSR provisions, coupled with the commercially-astute adaptive re-use component, came into play to enable a high volume of non-heritage commercial development to accompany the heritage-listed GPO retail / hotel adaptation. The non-heritage commercial component was of sufficient magnitude to generate a financially-positive cashflow from the entire combined development scheme.

In a conceptual sense, this was also the case in the Parramatta CBD example, where extra land was similarly available, but on a much smaller scale. There, the 1978 development consent (which was very much a pioneer model for its era) provided for a new non-heritage medium-rise office tower to be erected beside and behind a pre-existing Colonial heritage residence. The residence was adaptively re-used as commercial offices, to accompany the new adjacent office development. The combined investment asset still performs most satisfactorily, some twenty two years on.

(viii) While the evidence shows that Project Costs increased mildly in all of the subject cases as a result of the presence of the heritage listing, these cost increases were eclipsed and superceded several times over by the positive proportional added value which was achieved through the FSR bonuses conferred in each case. In the Maitland (country-regional) example, the adaptive re-use provisions alone provided sufficient financial inducement.

(ix) We believe that the presence of a heritage listed building in a property redevelopment proposal, does, prima facie, represent an increase in the project risk exposure for the developer. The risk lies in the fact that a heritage listing introduces an additional overlay onto (or, if you like, an additional complicating extension to) the often already-complex considerations associated with the development approval and environmental planning process.

However, in the four redevelopment case studies the additional project risk was accepted by each developer, and the project outcomes and future market expectations have in the eyes of the participants justified the additional risk so taken. The degree of additional heritage risk is, in our opinion, a matter for individual analysis and decision, based on the merits, circumstances and financial inducements pertaining to different cases. In our nominated case studies, a preparedness to adapt to the risks of the situation was displayed by all parties, on all sides, who had a stake-hold in the particular development project and the development approval process.

(x) In our opinion, the findings from our Case Studies comprehensively eradicate the frequently-voiced myth that '*nothing can be done with heritage-listed properties, they can't be redeveloped or altered*', and the notion that somehow heritage-listed properties are '*frozen in their existing state and existing use for all time*'.

In all four of our redevelopment cases, it has been demonstrated that the heritage-listed buildings concerned have experienced a notable rejuvenation of life and transformation of use, in the commercial, heritage-protection and socio-cultural senses. In most of the cases, the subject buildings prior to redevelopment and adaptive re-use were, to various degrees, in either a semi-used or a disused, run-down condition, due in no small part to technological and socio-economic change which had eclipsed the uses for which they were originally built. On a before-and-after comparison, the multiple-benefit outcomes, both private and public, are clear.

In closing, final mention must also be made of the important public benefit which has resulted in all four of our redevelopment Case Studies. Compared to the very restricted opportunities for public access in their former original operating modes, well prior to redevelopment, the case-study buildings now individually offer a degree and quality of public use, public access and public interaction which has been magnified many times over. The underlying 'public good' rationale which underpins the heritage system could not, in our opinion, be better demonstrated than in our four chosen redevelopment case studies.

5.2 Commercial Asset Management of Existing-Use Heritage Properties

(i) Our focus under this category is upon our three passive investment Case
Studies - the Strand Arcade, Moran House and Macquarie St, Parramatta.

These cases are different in character to our four redevelopment case studies, since they comprise long-standing existing-use based commercial investment assets. While they have all been subject to periodical refurbishment programs to various degrees in recent years, they have not been subject to massive redevelopment and adaptive re-use schemes. Unlike our four redevelopment case studies (with the notable exception of the low-impact Parramatta example), the heritage buildings in these cases continue to be used, by and large, for the purposes for which they were originally built and designed.

(ii) The Parramatta heritage-listed converted colonial residence example comprises, in our opinion, a successfully operating commercial investment asset, with no outstanding problems or concerns apparent from a property asset management and life-cycle costing standpoint.

This is directly due in part to the recent refurbishment works carried out, but it is also due to the particular character of the asset in a commercial investment sense. The overwhelming bulk of the floor space, net cashflow and operating expenses occur in the adjacent seven-storey non-heritage office building on the subject property, not the freestanding two-storey colonial residence. The heritage building comprises only a very small, but nevertheless clearly beneficial, part of the investment whole.

The subject heritage-listed building contributes 5.27% of the net leaseable area of the whole investment asset, yet it yields 6.25% of the gross rental cashflow from the property. It contributes approximately 6.6% to the total investment value of the asset, based on the evidence available. Its impact in terms of relative operating costs and life cycle costing issues is, in relative terms, minimal, yet it is viewed as a worthwhile cashflow bonus, contributing to the worth of the whole investment asset in the eyes of the new owner, according to the anecdotal evidence supplied to us by Mr Ian Gray, Commercial Sales & Leasing Manager, Jones Lang La Salle Parramatta (personal communications, 19/9/00).

In our opinion this example serves as a good demonstrative model applicable to any built environment elsewhere in Australia, of the manner in which a small residential heritage asset located in a commercial centre can be both protected in a heritage significance sense, while at the same time enabling a viable commercial adaptive re-use scheme to operate, utilising the erection of non-heritage development on available excess land.

(iii) Our two Sydney CBD passive investment examples both constitute somewhat small, underdeveloped assets in the commercial sense, situated on somewhat inferior quality, undersized narrow sites. Because they comprise, in relative terms, pre-existing inefficient commercial investment assets by virtue of their age and small size and design, it clear that, again relatively speaking, they consequently possess inefficiencies in annual operating costs, irrespective of any specific use limitations under the subject heritage listings.

In the case of the Strand Arcade - predominantly a tenanted retail use - it is difficult to discern any additional degree of annual operating expense which is solely attributable to any specific use limitations in the heritage listing. In a purely commercial sense, some would argue that the existing building envelope is about the most economic one possible, all other things being equal.

In the case of Moran House - an owner occupied office building use - there is more substantial anecdotal evidence to suggest that annual operating costs have increased as a direct result of use restrictions embodied in the heritage listing. The exact degree of extra cost is difficult to determine due to insufficiently detailed evidence, but a guideline proportion of around 10% extra outgoings cost per annum was suggested to us by the owner's representative with whom we spoke.

(iv) Both the Strand Arcade and Moran House were purchased several years ago by their current owners, who paid market prices which reflected and allowed for all of the property characteristics mentioned above.

Both properties appear to be currently performing satisfactorily for the owners, relative to the purchase prices paid. In both cases, the owners have recently wished to embark upon significant refurbishment and design-alteration programs, intended to enhance future value. However, important re-design elements in both proposals (which are separate from other refurbishment proposals which have been approved) have been refused on heritage-related grounds.

The potential perhaps exists for the owners of the Strand Arcade to meet the criteria for the award of Heritage Floor Space by undertaking further heritage restoration works. The HFS so secured might then be sold off in the market place to provide a sinking fund for future life-cycle costing works. In the case of Moran House, it has been confirmed that, in principle, the owners are already eligible for an award of HFS.

In both cases the greatest potential for positive economic and financial impacts from the heritage-listing perspective would appear to lie in the utilisation by the owners of the potential for securing saleable HFS awards, combined with the potential annual savings achieveable through discounted Heritage Land value determinations which are used for Land Tax assessments.

5.3 Summary Conclusions

The chief objectives of this research project are linked to the development economics of heritage-listed commercial property assets. Accordingly, our summary conclusions are as follows :

- In property development terms, economic viability is first and foremost dependent upon pre-emptive market-related factors which are not generally related to heritage considerations. The identification of unmet market demand, the presence of favourable market conditions, and the desirability of favourable timing in the relevant property cycle are essential pre-requisites for economic success in property development, regardless of whether a chosen property is heritage listed or non heritage listed. Heritage considerations come into play only after these pre-requisites have first been satisfied.

- While our case studies show that Project Costs increased mildly in each instance due to the impact of the subject heritage listing, the Added Value component measured through the award of Floor Space bonuses exceeded the Added Cost component by a considerable margin in each case study example. In the chosen Sydney CBD case studies, a pre-Olympics hotels-related FSR bonus scheme in effect replaced the otherwise orthodox eligibility provisions for the award of Heritage Floor Space. Rating and taxing subsidies, depending on the nature and characteristics present in any given case, also have the potential to offer considerable cost savings in an ongoing asset management sense.

- The combination of financial incentives and the commercially-oriented nature of the adaptive re-use schemes in each of our Sydney CBD case studies outweighed any extra heritage-related costs and project risks which so arose, thereby resulting in positive economic outcomes in each of our CBD examples. The country-regional example proved to be economically successful on the strength of the adaptive re-use provisions alone.

All four of the redevelopment case study properties possess sound prospects for successful future ongoing performance in a commercial investment sense.

5.4 Recommendations For Future Research

The following categories can perhaps be viewed as a potential 'wish-list' for meaningful, fruitful future research directions within the heritage system, should government funding and resources ever be available and extended to heritage managers to underwrite them.

(i) Existing-Use Scenarios in Heritage-Listed Commercial Buildings.
Asset Management Focus

In this category, ours was very much a preliminary ‘pilot study’ only. The information gleaned from our field investigations was very incomplete, which affected the quality and precision of our findings. Were our findings merely one-out anomalies, or were they part of a more widely-occurring pattern ? The question, until further researched, is at present unanswerable.

In our present consultancy undertaking, resource and budgetary constraints prevented the examination of *multiple* cases of either CBD office buildings or retail assets where the existing office or retail use (or mixed use) is maintained under the umbrella of the heritage listing - as opposed to a major adaptive re-use / redevelopment scheme. It is recommended that further research be pursued in the future, concentrating on multiple core CBD examples, to attempt to discern trends or patterns in the economic impact of heritage listings on achieveable rentals, annual operating costs, and life-cycle costing issues.

(ii) Further Non-Core CBD Commercial Studies

Only one of our six case studies in the Sydney Metropolitan Area involved a significant commercial asset located outside of the central Sydney CBD. Once more, resource constraints prevented a wider selection of non-core CBD commercial locations in our case study series.

Yet, significant high-value heritage-listed commercial assets exist in suburban and Sydney Regional CBD’s, beyond the boundaries of the central CBD - just as they do (albeit to lesser extents) in other capital cities around Australia.

Issues suitable for exploration might comprise the economic impact of heritage listings in such non-core locations, and the nature of heritage concessions / financial inducements in these precincts. For example, does the use of HFS by local government authorities exist in non-core CBD commercial precincts, and to what degree ? What other financial incentives are used, and to what degree, in practice ?

(iii) Further Country and Regional Based Studies

Only one out of our seven case studies, for resource reasons already mentioned, involved a country-regional based example. The outcomes of this ex-city example were very positive, however, and on the limited scope of information available, this case provides worthwhile guidance in our opinion for similar scenarios elsewhere around Australia.

It is well documented that rural regions around Australia are suffering, both economically, demographically, and also in a socio-cultural dimension. In some cases, a 'slow death' seems to be occurring for many smaller country towns.

In our opinion, it would be a fruitful undertaking to further research the manner in which the rejuvenation and transformation of country-based heritage assets, on an individual property and adaptive re-use case study basis, contributes to the economic well-being and restoration of the town or region concerned. Such studies could also extend well beyond mere economic rationalist limitations, and could venture into wider, more fundamental socio-cultural and quality-of-life domains. Can the trends of economic and social deterioration in urban areas of rural and regional Australia be mitigated or even reversed by the application of adaptive re-use schemes in heritage environments ? If so, to what degree ?

(iv) The Lending Attitudes of Financiers in Their Approach to Heritage-Listed Commercial Assets

We are unaware of any major studies, if any, as yet conducted in this direction.

Those who object to the statutory heritage protection and preservation process sometimes adopt the argument that financiers *universally* and indisputably regard heritage listed commercial property assets in a negative manner. The argument runs that this then allegedly, consequentially and without exception, flows through into loss of value to the asset concerned.

Here is another of the 'fact or fiction' conundrums which tend to orbit the periphery of the heritage system at the current point in time. Is this argument a myth ? Is there an *element* of truth to it ? If so, to what degree ? Or do financiers approach lending proposals in heritage-listed commercial property scenarios in the same basic manner as they do in other, non-heritage situations ?

(v) The Approach to Heritage-Listed Commercial Property Assets By Building Insurers

This appears to be another as yet incompletely explored domain. The limited research information already available has tended to indicate somewhat mixed, unclear outcomes and conclusions.

How do building insurers approach the prospect of insurance in heritage listed commercial property environments ? Do they identify any higher replacement cost risk element, and if so, do they accept it ? Do building insurers apply weighted premiums in a replacement cost context ?

Such hypotheses in our view would be worthy of further investigation.

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